

**BEFORE THE
COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATION AND ENERGY**

Investigation by the Department of)	
Telecommunications and Energy upon its own)	
Motion Commencing a Notice of Inquiry)	D.T.E. 98-32
Pursuant to 220 C.M.R. §§ 2.00, <i>et seq.</i>,)	
Into the Unbundling of All Natural)	
Gas Local Distribution Companies' Services)	

INITIAL RESPONSE OF THE NATIONAL MARKETERS

Pursuant to the DTE's April 14, 1998 follow-up data requests, Amoco Energy Trading, Inc., and Duke Energy Trading and Marketing, L.L.C. (collectively, the National Marketers), hereby provide the following joint initial response to the portion of Request No. 2, "Capacity Assignment Principles," directed at the LDC's capacity portfolio auction proposal.¹

INTRODUCTION AND SUMMARY OF POSITION

The National Marketers are a group of large marketers who market energy and provide energy services to *both wholesale and retail industrial and commercial* customers across the nation. The National Marketers have sufficient size and scope of operation to participate in the LDC capacity portfolio auction that is being proposed by the Massachusetts LDCs.

To date, three competing capacity disposition proposals have been placed on the table by the various stakeholder groups. Each proposal has its strong points, and each has its

¹ This initial response is being submitted out of time due to scheduling difficulties among the sponsoring parties. Since this filing contains useful information that will help develop the administrative record in this proceeding, the National Marketers submit that their Initial Response will aid the Department in reaching a reasoned decision regarding the unbundling of LDC services in Massachusetts. Moreover, as no responsive pleadings are permitted, no party can be prejudiced by this brief filing delay. For these reasons, the National Marketers respectfully request that the Department accept and consider this initial response.

flaws. After consideration of each, however, the National Marketers are of the opinion that capacity portfolio auction proposal set forth by the LDCs is the approach that has the best chance of delivering immediately the benefits of competition to the widest range of gas consumers, while simultaneously setting the stage for the development of a vigorous competitive retail gas market.

Accordingly, the National Marketers urge the Department to adopt the LDCs' capacity portfolio auction proposal. In doing so, however, the Department should be careful not to approve any unwarranted restrictions on the Portfolio Manager's marketing activities, such as a prohibition on "on-system" retail marketing by the Portfolio Manager or additional codes of conduct applicable to the Portfolio Manager.

RESPONSE AND DISCUSSION

In Data Request No. 2, the DTE seeks input from stakeholders regarding the competing proposals for capacity disposition. While the National Marketers stand with their marketer brethren on most, if not nearly all, restructuring issues, they do part ways on one aspect of the capacity disposition debate. Specifically, the National Marketers do not dismiss, as do many of the smaller, retail-only marketers, the idea of an LDC capacity portfolio auction.

The National Marketers agree with the LDCs that such auctions provide a superior, market-driven mechanism for monetizing assets and rapidly flowing through to the largest number of customers the resulting benefits. In this way, all LDC customers — even those who do not immediately convert to transportation service, are able to share in the tangible benefits of competition far sooner. In addition, the auction process is the best way to generate a level of savings that will provide a buffer against any potential "stranded" costs

that may later become identified as more and more of the LDCs' customers convert from bundled sales service to transportation-only service.

Structured Transition

The National Marketers note that it is essential to structure the transition to a competitive retail market in a manner that achieves the highest possible savings. An orderly transition with defined parameters on capacity assignment is the only way to maintain the high degree of reliability that LDC customers expect. Such a structured process will also guarantee that the LDCs' supply portfolios will be valued at levels sufficient to enable the LDCs to offer price reductions to their existing sales customers. In this vein, the National Marketers support the LDCs' proposal to establish reasonable migration limits on the amount of customers that are permitted to convert to transportation service in any one year. From a commercial perspective these migration limits are necessary if prospective portfolio managers are to be able to proffer bids adequate to allow the LDCs to pass through cost savings to its customers.

Just as important, these migration limits will allow all marketers, their new customers, and the LDCs to learn from experience, thus minimizing the potential for the sort of customer service and operational miscues that might otherwise occur in an environment of unlimited conversions.² The National Marketers note that the transition to a transportation-only service environment will require the cooperation of the LDC, the Portfolio Manager, and all third-party suppliers to develop the necessary systems and organizational changes to

² Members of the National Marketers can provide meaningful bids in a portfolio auction, irrespective of the capacity assignment mechanism ultimately chosen by the Department, so long as reasonable migration limits are in place. These limits may be determined in the Collaborative, although the National Marketers could accept a 20% per year migration cap, as suggested in the LDCs' proposal.

ensure that city-gate deliveries are not compromised by the increase in the number of different suppliers making nominations.

Mitigation of Market Power

In its follow up data requests, the Department also urges the stakeholders to discuss the issue of market power under the portfolio auction approach and, specifically, what “restrictions” might be appropriate to place on Portfolio Managers to prevent competitive abuses by these managers.

The National Marketers urge caution in this area.

Preliminarily, the DTE should remember that each of the National Marketers has a retail marketing business, and, at this time, each intends to compete for certain retail customers throughout the entire state of Massachusetts. And at the same time, none of the National Marketers has the desire, not to mention the capability, to “corner” the LDC market as a portfolio manager. The National Marketers expect that the portfolio auction process will result in a number of different winners and, therefore, that each will be competing for retail business on several LDCs whose assets are managed by some other marketer.

For this reason, the National Marketers share the concerns articulated by some of the other marketers/aggregators about the possibility of competitive abuses by the portfolio managers in favor of their retail marketing divisions and/or affiliates.³ The DTE can and

³ Another, albeit less-often-voiced, objection to the portfolio auction approach is that, by yielding lower sales prices for the LDCs’ existing bundled sales customers, it compounds the difficulty some marketers may have in breaking into the market. This objection, which really amounts to a plea by certain marketers who choose not to compete in the portfolio auctions to be protected from price competition from those marketers who choose to participate in these auctions, simply is not credible. After all, the tools that portfolio managers will use to create these savings — creative and more efficient use of supply and capacity assets, use of various risk-management devices, access to cheaper supply and capacity sources, *etc.* — are the same tools that all

should deal with this possibility, however, without implementing onerous and unwarranted controls over portfolio managers.

The danger here is that “market power” controls, directed only to prospective portfolio managers, can make the prospect of operating as a Portfolio Manager so unattractive as to constitute a barrier to participation in the auction process,⁴ thus undermining the auction’s usefulness in maximizing savings for the LDCs’ customers.

In this regard, then, the DTE should not adopt the suggestion, mentioned in the LDCs portfolio auction proposal, that a Portfolio Manager and/or its retail affiliate be prohibited outright from competing for retail customers on the LDC system that it manages. In the short run, any such prohibition on retail access will undermine the auction process because, by making Portfolio Managers victims of their own success, it will very likely limit participation in the auction process, to the detriment of the LDCs’ sales customers. Marketers who might have submitted bids in three or four LDC auctions could be forced to limit their bidding to one LDC auction, or to forgo the auction process altogether. And in the longer run, the LDCs’ customers will be disserved by the arbitrary elimination of a competitor in the retail market.

marketers will use to create savings for their customers, and there is no valid basis for selectively denying certain marketers the right to use those tools to provide competitive price benefits to gas consumers in Massachusetts. The National Marketers point out that the auctions are not closed to any legitimate marketer, and those who are concerned about being disadvantaged by the auctions should participate in them. Under no circumstances, however, should the Department preclude all marketers from participating in an auction process simply because some of the marketers would prefer to sit on the sidelines.

⁴ The National Marketers recognize that this may be precisely the goal of those opposed to the portfolio auction process.

The second market power control is alluded to by the Department itself: the notion of additional codes of conduct, applicable to the winning Portfolio Manager. The Commission should resist such proposals as well.

As noted, additional codes of conduct can dissuade a marketer from participating in the portfolio auctions altogether, or, by adding regulatory compliance costs to the marketer's cost basis, they can limit the amount of savings a marketer can subsequently offer to its prospective retail customers. The second, and perhaps more compelling, reason why such codes of conduct should not be adopted, is simply that they are not necessary.

Under the portfolio auction approach, the LDC, not the individual sales customers, becomes the customer of the winning bidder. In this regard, then, the winning Portfolio Manager has no special advantage over any other marketer with respect to direct access to the individual bundled sales customers. Rather, the only potential source of competitive abuse by a Portfolio Manager is within the process for allocating the upstream assets controlled by the Portfolio Manager to other marketers who have signed up new customers.

This source of possible competitive mischief is in turn minimized by the fact that it is the LDC, not the Portfolio Manager, who controls the disposition of the upstream assets under clear assignment guidelines which spell out a marketer's rights to take upstream capacity for its customer load.⁵ The LDCs' assignment activities remain subject to the Department's jurisdiction and control, and the Department can step in if it determines that the LDC is unduly advantaging the Portfolio Manager.⁶

⁵ Clear guidelines are also essential for another purpose: bidders in the portfolio auctions must know their release obligations in order to value properly their bids.

⁶ The Department should, of course, establish guidelines to ensure that the auctions themselves are conducted in a fair, open, and non-discriminatory manner. In

In all of these circumstances, there is no reason to impose restrictive codes of conduct applicable only to those particular marketers who successfully compete for the right to become a Portfolio Manager.

CONCLUSION

The capacity auction mechanism brings an open and objective market solution to the problem of providing immediate competitive benefits to all Massachusetts gas consumers, even those customers who do not immediately select a third-party supplier. At the same time, this approach allows the competitive market for LDC transportation customers to develop in a structured, measured fashion, avoiding the “creation” of large amounts of stranded costs, and, importantly, allowing third-party suppliers, their new customers, and the LDCs to gain the experience necessary to ensure that the quality of customer service will be maintained during the transition to a fully-unbundled market.

For these reasons, the National Marketers support the LDCs’ capacity portfolio auction approach.

addition, the National Marketers would not oppose additional reporting requirements regarding the LDCs’ subsequent capacity assignment transactions with retail marketers.